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Municipal Bonds

Municipals could be big winners from recent and proposed federal stimulus

Boston - Investors look to the municipal market for both quality and diversification, and in 2020 this market proved resilient despite a challenging economic environment. Investment-grade municipals quickly rebounded from volatility in the spring to deliver solid returns for the year on the back of declining interest rates and stable credit fundamentals.

The strength of municipal credit quality surprised many, including forecasters who had envisioned doom and gloom earlier in 2020. The \$2.2 trillion CARES Act passed in April was instrumental in stabilizing the economy for much of the year, and proved essential in supporting many areas of municipal finance — including state and local governments, transportation, education and healthcare.

CARES stimulus follow-up to benefit municipal sectors

In December, the lame duck session of the U.S. Congress delivered the long-awaited follow-up to the CARES Act — the \$900 billion Coronavirus Response and Relief Supplemental Appropriations Act. While the bill did not include direct aid to state and local governments, it will provide over \$100 billion in aid to various municipal sectors.

One of the biggest beneficiaries of the new bill is the education sector: Elementary and secondary schools will receive \$54 billion in aid, and higher education will receive \$20 billion. Note that elementary and secondary education usually makes up the largest expense item in state General Funds, and states, on average, cover 47% of K-12 education costs. Therefore, the significant education assistance can be viewed as "back door" aid to states, giving them the ability to cut school funding while still making school budgets whole through the federal package.

Other sectors will also benefit from the bill:

- **\$14 billion for mass transit agencies** — Importantly, the aid will be distributed based on each provider's operating expenses, and the Municipal Transit Authority (MTA) of New York is expected to receive \$4 billion.
- **\$10 billion for highways** — This aid will go to state transportation departments and certain local transportation industries. While U.S. toll roads can benefit from robust liquidity levels, vehicle miles traveled were still down approximately 11% in October 2020 compared to the prior year according to Federal Reserve Economic Data (FRED).
- **\$3 billion for hospitals** — With COVID hospitalizations near record levels, hospitals were expecting greater support from this stimulus package. Throughout 2020, however, hospitals and other health care providers received a total of \$175 billion from various federal stimulus packages.
- **\$2 billion for airports** — In the third quarter of 2020, airport traffic was down 71% compared to the prior year, and volumes are expected to remain depressed

Picture of Bill

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through the first half of 2021 before rebounding in the second half, thanks to vaccinations. When combined with the \$10 billion in aid that airports received through the CARES Act, the aid from this package is expected to support most airport authorities into 2022.

Additional stimulus from the new administration

The Biden-Harris administration has identified further federal aid beyond this \$900 billion as a priority for 2021. The proposed aid would include direct support for state and local governments still struggling to cope with the ongoing health and economic crisis. Additional municipal sectors — including transportation, education and healthcare — would also benefit from the potential stimulus coming this year.

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Bottom line: This positive outlook on muni credit has already provided a lift to valuations, but perhaps more importantly, it could preserve both the quality and diversification that investors seek from the municipal asset class.

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